



CLEP[®]

Official Study Guide

16th Edition

Principles of Macroeconomics

College-Level Examination Program[®]

Visit our Web site at www.collegeboard.com/clep
for the most up-to-date information.

Copyright © 2004 by College Entrance Examination Board. All rights reserved.

Principles of Macroeconomics

Description of the Examination

The Principles of Macroeconomics examination covers material that is usually taught in a one-semester undergraduate course in introductory macroeconomics. This aspect of economics deals with principles of economics that apply to an economy as a whole, particularly the general price level, output and income, and interrelations among sectors of the economy. The test places particular emphasis on the determinants of aggregate demand and aggregate supply, on monetary and fiscal policy tools that can be used to achieve particular policy objectives. Within this context, candidates are expected to understand measurement concepts such as gross domestic product, consumption, investment, unemployment, inflation, inflationary gap, and recessionary gap. Candidates are also expected to demonstrate knowledge of the institutional structure of the Federal Reserve Bank and the monetary policy tools it uses to stabilize economic fluctuations and promote long-term economic growth, as well as the tools of fiscal policy and their impacts on income, employment, price level, deficits, and interest rate. Basic understanding of foreign exchange markets, balance of payments, effects of currency, and appreciation and depreciation on a country's imports and exports are also expected.

The examination contains 80 questions to be answered in 90 minutes. Some of these are pretest questions that will not be scored. Any time candidates spend on tutorials and providing personal information is in addition to the actual testing time.

Knowledge and Skills Required

Questions on the Principles of Macroeconomics examination require candidates to demonstrate one or more of the following abilities:

- Understanding of important economic terms and concepts
- Interpretation and manipulation of economic graphs
- Interpretation and evaluation of economic data
- Application of simple economic models

The subject matter of the Principles of Macroeconomics examination is drawn from the following topics. The percentages next to the main topics indicate the approximate percentages of exam questions on those topics.

8–12% Basic economic concepts

Scarcity: the nature of the economic system
Opportunity costs and production possibilities curves
Demand, supply, and price determination

10–18% Measurement of economic performance

Gross domestic and national products and national income concepts
Inflation and price indices
Unemployment

60–70% National income and price determination

30–35% Aggregate supply and demand: Keynesian and classical analysis

- Circular flow
- Components of aggregate supply and demand
- Multiplier
- Fiscal policy
- Monetary policy
- Long vs. short run

10–15% Money and banking

- Definition of money and its creation
- Tools of central bank policy
- Role of central bank

20–25% Effectiveness of fiscal and monetary policy

- Interaction of fiscal and monetary policy
- Debts and deficits
- Stabilization policies for aggregate demand and supply shocks
- Keynesian, monetarist, supply-sider, and rational expectation theories

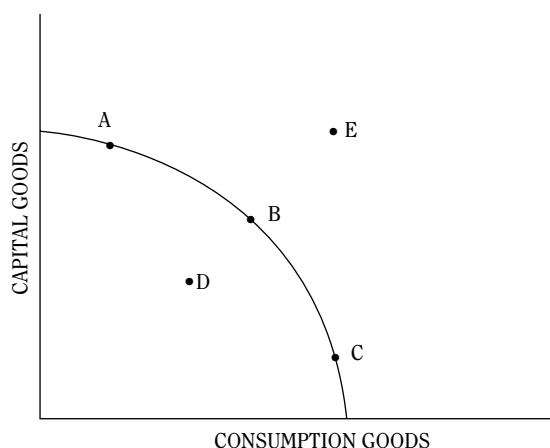
10–15% International economics and growth

Comparative advantage, trade policy, international finance, and exchange rates
Economic growth

Sample Test Questions

The following questions are provided to give an indication of the types of questions that appear on the Principles of Macroeconomics examination. CLEP examinations are designed so that average students completing a course in the subject can usually answer about half the questions correctly.

Directions: Each of the questions or incomplete statements below is followed by five suggested answers or completions. Select the one that is best in each case.



1. An economy that is fully employing all its productive resources but allocating less to investment than to consumption will be at which of the following positions on the production possibilities curve shown above?

(A) A
(B) B
(C) C
(D) D
(E) E

2. Assume that land can be used either for producing grain or for grazing cattle to produce beef. The opportunity cost of converting an acre from cattle grazing to grain production is the

(A) market value of the extra grain that is produced
(B) total amount of beef produced
(C) number of extra bushels of grain that are produced
(D) amount by which beef production decreases
(E) profits generated by the extra production of grain

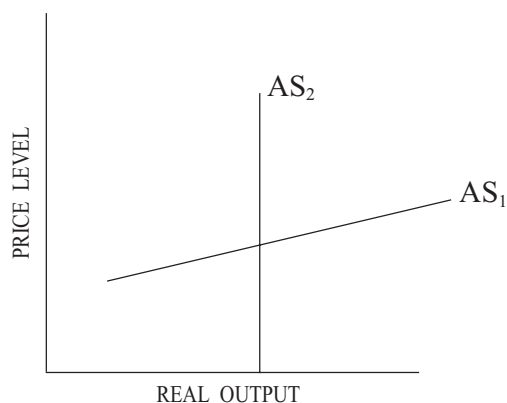
3. Which of the following will occur as a result of an improvement in technology?

(A) The aggregate demand curve will shift to the right.
(B) The aggregate demand curve will shift to the left.
(C) The aggregate supply curve will shift to the right.
(D) The aggregate supply curve will shift to the left.
(E) The production possibilities curve will shift inward.

4. Increases in real income per capita are made possible by

(A) improved productivity
(B) a high labor/capital ratio
(C) large trade surpluses
(D) stable interest rates
(E) high protective tariffs

5. Which of the following is an example of “investment” as used in economics?
- (A) A schoolteacher purchases 10,000 shares of stock in an automobile company.
 - (B) Newlyweds purchase a previously owned home.
 - (C) One large automobile firm purchases another large automobile firm.
 - (D) A farmer purchases \$10,000 worth of government securities.
 - (E) An apparel company purchases 15 new sewing machines.
6. The United States Department of Labor defines an individual as unemployed if the person
- (A) does not hold a paying job
 - (B) has been recently fired
 - (C) works part time but needs full-time work
 - (D) is without a job but is looking for work
 - (E) wants a job but is not searching because he or she thinks none is available
7. If businesses are experiencing an unplanned increase in inventories, which of the following is most likely to be true?
- (A) Aggregate demand is greater than real output.
 - (B) Aggregate demand is less than real output.
 - (C) The economy is growing.
 - (D) Planned investment is greater than planned saving.
 - (E) Planned investment is less than planned saving.
8. Which of the following workers is most likely to be classified as structurally unemployed?
- (A) A high school teacher who is unemployed during the summer months
 - (B) A recent college graduate who is looking for her first job
 - (C) A teenager who is seeking part-time employment at a fast-food restaurant
 - (D) A worker who is unemployed because his skills are obsolete
 - (E) A person who reenters the job market after relocating
9. According to the classical model, an increase in the money supply causes an increase in which of the following?
- I. Real gross domestic product
 - II. Nominal gross domestic product
 - III. Nominal wages
- (A) I only
 - (B) II only
 - (C) III only
 - (D) II and III only
 - (E) I, II, and III



10. The diagram above shows two aggregate supply curves, AS_1 and AS_2 . Which of the following statements most accurately characterizes the AS_1 curve relative to the AS_2 curve?

- (A) AS_1 is Keynesian because it reflects greater wage and price flexibility.
- (B) AS_1 is classical because it reflects greater wage and price flexibility.
- (C) AS_1 is Keynesian because it reflects less wage and price flexibility.
- (D) AS_1 is classical because it reflects less wage and price flexibility.
- (E) AS_1 could be either classical or Keynesian because it reflects greater wage flexibility but less price flexibility.

11. An increase in which of the following would cause the long-run aggregate supply curve to shift to the right?

- (A) Corporate income tax rates
- (B) Aggregate demand
- (C) Labor productivity
- (D) The average wage rate
- (E) The price level

12. According to the classical economists, which of the following is most sensitive to changes in interest rates?

- (A) Consumption
- (B) Investment
- (C) Government spending
- (D) Transfer payments
- (E) Intermediate goods

13. In the circular flow diagram of an economy, which of the following is true?

- (A) Businesses pay wages, rent, interest, and profits to households in return for use of factors of production.
- (B) Businesses purchase goods and services from households in return for money payments.
- (C) Households pay wages, rent, interest, and profits to businesses in return for use of factors of production.
- (D) The relationship between households and businesses exists only in a traditional society.
- (E) The relationship between households and businesses exists only in a command economy.

14. Which of the following would most likely lead to a decrease in aggregate demand?

- (A) A decrease in taxes
- (B) A decrease in interest rates
- (C) An increase in household savings
- (D) An increase in household consumption
- (E) An increase in business firms' purchases of capital equipment from retained earnings

15. According to the Keynesian model, equilibrium output of an economy may be less than the full-employment level of output because at full employment

- (A) sufficient income may not be generated to keep workers above the subsistence level
- (B) there might not be enough demand by firms and consumers to buy that output
- (C) workers may not be willing to work the hours necessary to produce the output
- (D) interest rates might not be high enough to provide the incentive to finance the production
- (E) banks may not be willing to lend enough money to support the output

16. If the Federal Reserve lowers reserve requirements, which of the following is most likely to happen to interest rates and nominal gross domestic product?

<u>Interest Rates</u>	<u>Nominal Gross Domestic Product</u>
(A) Increase	Decrease
(B) Increase	Increase
(C) Decrease	Decrease
(D) Decrease	Increase
(E) No change	No change

17. If the marginal propensity to consume is 0.9, what is the maximum amount that the equilibrium gross domestic product could change if government expenditures increase by \$1 billion?

- (A) It could decrease by \$9 billion.
- (B) It could increase by \$0.9 billion.
- (C) It could increase by \$1 billion.
- (D) It could increase by \$9 billion.
- (E) It could increase by \$10 billion.

18. Expansionary fiscal policy will be most effective in increasing real gross domestic product when

- (A) the aggregate supply curve is horizontal
- (B) the economy is at or above full-employment output
- (C) transfer payments are decreased, while taxes remain unchanged
- (D) wages and prices are very flexible
- (E) the Federal Reserve simultaneously increases the reserve requirement

19. Which of the following would increase the value of the simple spending multiplier?

- (A) An increase in government expenditure
- (B) An increase in exports
- (C) A decrease in government unemployment benefits
- (D) A decrease in the marginal propensity to consume
- (E) A decrease in the marginal propensity to save

20. Assume that the reserve requirement is 25 percent. If banks have excess reserves of \$10,000, which of the following is the maximum amount of additional money that can be created by the banking system through the lending process?

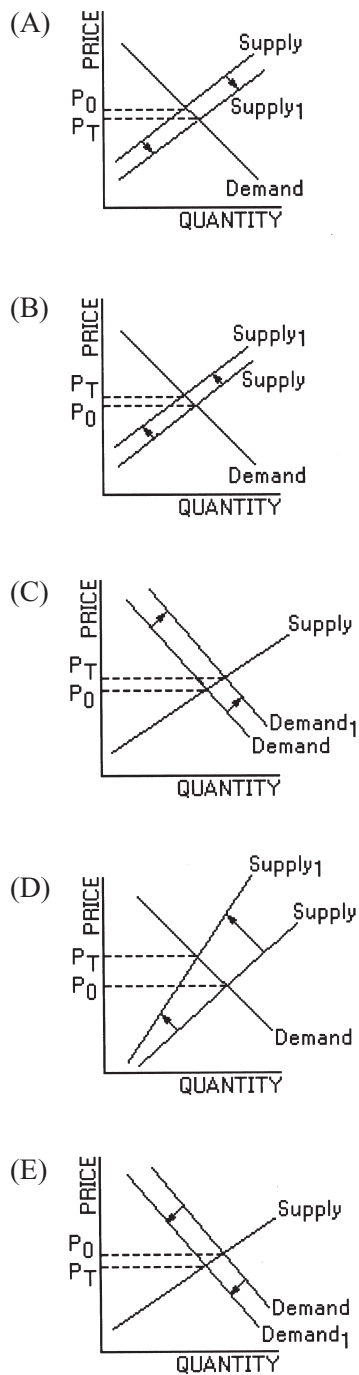
- (A) \$2,500
- (B) \$10,000
- (C) \$40,000
- (D) \$50,000
- (E) \$250,000

21. The principal reason for requiring commercial banks to maintain reserve balances with the Federal Reserve is that these balances
- (A) provide the maximum amount of reserves a bank would ever need
 - (B) give the Federal Reserve more control over the money-creating operations of banks
 - (C) ensure that banks do not make excessive profits
 - (D) assist the Treasury in refinancing government debt
 - (E) enable the government to borrow cheaply from the Federal Reserve's discount window
22. The purchase of securities from the public in the open market by the Federal Reserve will
- (A) increase the supply of money
 - (B) increase the interest rate
 - (C) increase the discount rate
 - (D) decrease the number of Federal Reserve notes in circulation
 - (E) decrease the reserve requirement
23. To counteract a recession, the Federal Reserve should
- (A) buy securities on the open market and raise the reserve requirement
 - (B) buy securities on the open market and lower the reserve requirement
 - (C) buy securities on the open market and raise the discount rate
 - (D) sell securities on the open market and raise the discount rate
 - (E) raise the reserve requirement and lower the discount rate
24. Total spending in the economy is most likely to increase by the largest amount if which of the following occur to government spending and taxes?
- | <u>Government Spending</u> | <u>Taxes</u> |
|----------------------------|--------------|
| (A) Decrease | Increase |
| (B) Decrease | No change |
| (C) Increase | Increase |
| (D) Increase | Decrease |
| (E) No change | Increase |
25. According to the Keynesian model, an increase in the money supply affects output more if
- (A) investment is sensitive to changes in interest rates
 - (B) money demand is sensitive to changes in interest rates
 - (C) the unemployment rate is low
 - (D) consumption is sensitive to the Phillips curve
 - (E) government spending is sensitive to public opinion
26. Supply-side economists argue that
- (A) a cut in high tax rates results in an increased deficit and thus increases aggregate supply
 - (B) lower tax rates provide positive work incentives and thus shift the aggregate supply curve to the right
 - (C) the aggregate supply of goods can only be increased if the price level falls
 - (D) increased government spending should be used to stimulate the economy
 - (E) the government should regulate the supply of imports

27. Which of the following policies would most likely be recommended in an economy with an annual inflation rate of 3 percent and an unemployment rate of 11 percent?
- (A) An increase in transfer payments and an increase in the reserve requirement
 - (B) An increase in defense spending and an increase in the discount rate
 - (C) An increase in income tax rates and a decrease in the reserve requirement
 - (D) A decrease in government spending and the open market sale of government securities
 - (E) A decrease in the tax rate on corporate profits and a decrease in the discount rate
28. According to the monetarists, inflation is most often the result of
- (A) high federal tax rates
 - (B) increased production of capital goods
 - (C) decreased production of capital goods
 - (D) an excessive growth of the money supply
 - (E) upward shifts in the consumption function
29. According to the Keynesian model, an expansionary fiscal policy would tend to cause which of the following changes in output and interest rates?
- | <u>Output</u> | <u>Interest Rates</u> |
|---------------|-----------------------|
| (A) Increase | Increase |
| (B) Increase | Decrease |
| (C) Decrease | Increase |
| (D) Decrease | Decrease |
| (E) No change | Decrease |
30. Which of the following would result in the largest increase in aggregate demand?
- (A) A \$30 billion increase in military expenditure and a \$30 billion open market purchase of government securities
 - (B) A \$30 billion increase in military expenditure and a \$30 billion open market sale of government securities
 - (C) A \$30 billion tax decrease and a \$30 billion open market sale of government securities
 - (D) A \$30 billion tax increase and a \$30 billion open market purchase of government securities
 - (E) A \$30 billion increase in social security payments and a \$30 billion open market sale of government securities
31. Which of the following measures might be used to reduce a federal budget deficit?
- I. Increasing taxes
 - II. Decreasing federal spending
 - III. Decreasing interest rates
- (A) I only
 - (B) II only
 - (C) III only
 - (D) I and III only
 - (E) I, II, and III
32. Which of the following would most likely be the immediate result if the United States increased tariffs on most foreign goods?
- (A) The United States standard of living would be higher.
 - (B) More foreign goods would be purchased by Americans.
 - (C) Prices of domestic goods would increase.
 - (D) Large numbers of United States workers would be laid off.
 - (E) The value of the United States dollar would decrease against foreign currencies.

33. Which of the following policies is most likely to encourage long-term economic growth in a country?
- (A) An embargo on high-technology imports
 - (B) A decrease in the number of immigrants to the country
 - (C) An increase in government transfer payments
 - (D) An increase in the per capita savings rate
 - (E) An increase in defense spending
34. Which of the following would occur if the international value of the United States dollar decreased?
- (A) United States exports would increase.
 - (B) More gold would flow into the United States.
 - (C) United States demand for foreign currencies would increase.
 - (D) The United States trade deficit would increase.
 - (E) United States citizens would pay less for foreign goods.
35. If exchange rates are allowed to fluctuate freely and the United States demand for German marks increases, which of the following will most likely occur?
- (A) The dollar price of German goods will increase.
 - (B) The mark price of United States goods will increase.
 - (C) The United States balance-of-payments deficit will increase.
 - (D) The dollar price of marks will fall.
 - (E) The dollar price of German goods will fall.
36. The replacement of some portion of the federal personal income tax with a general sales tax would most likely result in
- (A) greater overall progressivity in the tax structure
 - (B) lesser overall progressivity in the tax structure
 - (C) stronger automatic stabilization through the business cycle
 - (D) a larger budget deficit
 - (E) a smaller federal budget deficit
37. A deficit in the United States trade balance can be described as
- (A) an excess of the value of commodity imports over the value of merchandise exports
 - (B) an excess of the value of merchandise exports over the value of commodity imports
 - (C) an excess of payments to foreigners over receipts from foreigners
 - (D) an almost complete depletion of the gold stock
 - (E) an excess of receipts from foreigners over payments to foreigners
38. Problems faced by all economic systems include which of the following?
- I. How to allocate scarce resources among unlimited wants
 - II. How to decentralize markets
 - III. How to decide what to produce, how to produce, and for whom to produce
 - IV. How to set government production quotas
- (A) I only
 - (B) I and III only
 - (C) II and III only
 - (D) I, II, and III only
 - (E) I, II, III, and IV
39. An increase in which of the following will cause an increase in the demand for a certain good?
- (A) The price of the good
 - (B) The number of sellers of the good
 - (C) The price of a complementary good
 - (D) The cost of purchasing the good
 - (E) The number of buyers of the good

40. Assume that the government imposes a per unit tax on the production of a certain good. In the graphs below, P_0 indicates the price before the implementation of the tax and P_T indicates the price after the implementation of the tax. Which of the following is a graphical representation of this situation?



41. Which of the following groups is most likely to experience losses if inflation increases unexpectedly?

- (A) Lenders
- (B) Borrowers
- (C) Workers with variable-wage contracts
- (D) Owners of real estate
- (E) People who hold noncash assets

42. Assume that last year the consumer price index (CPI) was 150 and a household's nominal income was \$30,000. If the CPI this year is 160, to be as well off as last year, the household should have an increase in nominal income of

- (A) \$1,800
- (B) \$1,875
- (C) \$2,000
- (D) \$3,000
- (E) \$4,800

43. The natural rate of unemployment can be defined as the unemployment rate that exists when the economy

- (A) is neither growing or shrinking
- (B) has zero inflation
- (C) has only cyclical and structural unemployment
- (D) has no trade deficit or government deficit
- (E) produces at the full-employment output level

44. New classical economists believe that a fully anticipated expansionary fiscal policy will cause the price level and real output to change in which of the following ways in the long run?

<u>Price Level</u>	<u>Real Output</u>
(A) Increase	Increase
(B) Increase	No change
(C) No change	No change
(D) Decrease	Increase
(E) Decrease	Decrease

45. If the nominal gross domestic product is \$8 trillion and the money supply is \$2 trillion, the velocity of money is

- (A) 2
- (B) 4
- (C) 6
- (D) 10
- (E) 16

46. Which of the following is NOT true of the Federal Reserve?

- (A) It serves as a lender of last resort for member banks.
- (B) It supervises member banks.
- (C) It provides check-clearing services.
- (D) It issues traveler's checks.
- (E) It controls the money supply.

47. Which of the following best describes crowding out?

- (A) Competition between the government and private borrowers for loanable funds results in an increase in interest rates.
- (B) Increases in the costs of inputs lead to decreases in domestic production.
- (C) The Federal Reserve's open-market operations decrease the amount of funds banks have available for lending.
- (D) Reductions in the government's budget deficit lead to fewer Treasury bonds being issued.
- (E) The scarcity of funds forces Congress to decrease spending on critical public works programs.

48. Suppose that the economy is operating at full employment. If the government wants to discourage consumption spending, stimulate investment spending, and maintain full-employment output, which of the following combinations of monetary and fiscal policies would most likely achieve these goals?

<u>Monetary Policy</u>	<u>Fiscal Policy</u>
(A) Increase money supply	Increase government spending
(B) Increase money supply	Increase personal income taxes
(C) Decrease money supply	Increase government spending
(D) Decrease money supply	Increase personal income taxes
(E) Decrease money supply	Decrease personal income taxes

49. If the Federal Reserve suddenly increases the growth rate of the money supply from 4 percent to 8 percent per year, interest rates, aggregate demand, and nominal gross domestic product (GDP) will most likely change in which of the following ways in the short run?

<u>Interest Rates</u>	<u>Aggregate Demand</u>	<u>Nominal GDP</u>
(A) Increase	Increase	Increase
(B) Increase	Decrease	Increase
(C) Decrease	Increase	Increase
(D) Decrease	Increase	Decrease
(E) Decrease	Decrease	Increase

50. The United States federal government budget deficits tend to be large when which of the following is low?

- (A) The interest rate on government bonds
- (B) The growth rate of the economy
- (C) The unemployment rate
- (D) The inflation rate
- (E) The international value of the United States dollar

Study Resources

Most textbooks used in college-level introductory macroeconomics courses cover the topics in the outline given earlier, but the approaches to certain topics and the emphasis given to them may differ. To prepare for the Principles of Macroeconomics exam, it is advisable to study one or more college textbooks, which can be found in most college bookstores. When selecting a textbook, check the table of contents against the “Knowledge and Skills Required” for this test.

There are many introductory economics textbooks that vary greatly in difficulty. Most books are published in one-volume editions, which cover both microeconomics and macroeconomics; some are published in two-volume editions, with one volume covering macroeconomics and the other microeconomics. A companion study guide/workbook is available for most textbooks. The study guides typically include brief reviews, definitions of key concepts, problem sets, and multiple-choice test questions with answers. Many publishers also make available computer-assisted learning packages.

To broaden your knowledge of economic issues, you may read relevant articles published in the economics periodicals that are available in most college libraries — for example, *The Economist*, *The Wall Street Journal* and the *New York Times*, along with local papers, may also enhance your understanding of economic issues. The Internet is another resource you could explore.

Additional suggestions for preparing for CLEP exams are given in “Preparing to Take CLEP Examinations.”

Answer Key

1.	C	26.	B
2.	D	27.	E
3.	C	28.	D
4.	A	29.	A
5.	E	30.	A
6.	D	31.	E
7.	B	32.	C
8.	D	33.	D
9.	D	34.	A
10.	C	35.	A
11.	C	36.	B
12.	B	37.	A
13.	A	38.	B
14.	C	39.	E
15.	B	40.	B
16.	D	41.	A
17.	E	42.	C
18.	A	43.	E
19.	E	44.	B
20.	C	45.	B
21.	B	46.	D
22.	A	47.	A
23.	B	48.	B
24.	D	49.	C
25.	A	50.	B